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IN THE

Supreme Court of the United States

October Term, 1973

BANGOR PUNTA OPERATIONS, INC. and
BANGOR PUNTA CORPORATION,
Petitioners,

v.

BANGOR & AROOSTOOK RAILROAD COMPANY
and BANGOR INVESTMENT COMPANY,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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October 31, 1973

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Petitioners, Bangor Punta Operations, Inc. and Bangor Punta Corporation, Defendants-Appellees below, pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the First Circuit which was entered on August 3, 1973.

Opinions Below

The opinion of the District Court for the District of Maine is reported at 353 F. Supp. 724 (D. Me. 1972) and is reproduced at pp. 1a-12a of the Appendix hereto (App.). The opinion of the Court of Appeals (App. pp. 13a-26a) has not yet been officially reported.

Jurisdiction

The decision of the First Circuit, reversing the decision of the District Court, was entered on August 3, 1973. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254 (1).

Questions Presented

(1) Whether, notwithstanding this Court's decision in *Sierra Club* v. *Morton*, 405 U.S. 727 (1972), the Court of Appeals for the First Circuit can allow a party, which has itself suffered no injury, to maintain an action for the benefit of the general public.

(2) Whether the fact that a corporation is a railroad suspends the applicable rules with respect to standing so as to permit actions by the general public for alleged violations of the securities and antitrust laws and for corporate waste and mismanagement.

(3) Whether the contemporaneous share ownership requirement embodied in Rule 23.1 of the Federal Rules of Civil Procedure should be abandoned with respect to actions involving corporations whose business affects the public welfare.

Statutes and Regulations Involved

The following statutes and regulations are involved: Clayton Act § 10, 15 U.S.C. § 20; Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b); SEC Rule 10b-5, 17 C.F.R. § 240.10b-5; and Rule 23.1 of the Federal Rules of Civil Procedure. The text of pertinent parts of the statutes and regulations are set forth at pp. 27a to 29a in the Appendix hereto.

Statement of the Case

This is an action brought nominally by the Bangor and Aroostook Railroad Corporation (BAR) and its wholly-

owned subsidiary, Bangor Investment Company (BIC), against BAR's former owners, Bangor Punta Operations, Inc. (BPO) and Bangor Punta Corporation (Bangor Punta). Plaintiffs allege mismanagement, misappropriation, and waste of corporate assets during the period defendants owned 98.3% of the outstanding capital stock of BAR. Plaintiffs also allege that certain of these transactions violated Section 10 of the Clayton Act (15 U.S.C. § 20), Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) and Rule 10b-5 thereunder, the Maine Public Utilities Act, and the common law of Maine.

While BAR and BIC are the named plaintiffs, the real plaintiff and party in interest is The Amoskeag Company ("Amoskeag"), a Delaware investment company which owns virtually all of BAR's outstanding common stock. On October 2, 1969, Amoskeag purchased the defendants' 98.3% interest in BAR for approximately $5,000,000, and since that date has increased its holdings to approximately 99.3%. Since October 1, 1969, Amoskeag has exercised the effective control and management of BAR.

On September 14, 1972, defendants moved for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure. By order dated December 29, 1972, the United States District Court for the District of Maine (Edward T. Gignoux, D.J.) awarded defendants summary judgment and dismissed the action on the ground that, from the undisputed facts of the case, plaintiffs were precluded by well established equitable principles from maintaining the action.

The District Court's opinion emphasized three crucial and uncontested facts: 1) the real plaintiff and party in interest and beneficiary of any recovery was Amoskeag, the 99% owner of the corporate plaintiffs; 2) Amoskeag, which purchased its BAR stock in October, 1969, was not a shareholder at the time the alleged wrongs to the corporate plaintiffs occurred; and 3) Amoskeag made no claim that

it was deceived nor that it received anything but full value when it bought its BAR stock (App. pp. 3a-4a).

On the basis of these undisputed facts, the District Court found that Amoskeag had sustained no injury, direct or indirect, and held that the suit which it had caused to be brought by the corporate plaintiffs was in reality a suit by a stock purchaser who had received fair value, seeking to recover back its purchase price (plus an additional windfall of $2,000,000), while at the same time retaining the stock. (App. pp. 4a, 7a) The Court refused to permit Amoskeag to so use the corporation to enrich itself unjustly, and dismissed the suit.

On August 3, 1973, the United States Court of Appeals for the First Circuit reversed the District Court's decision. The Court of Appeals did not reject the continuing validity of the principles applied by the District Court in dismissing BAR's claim and, in fact, recognized that Amoskeag was totally lacking in equity. (App. p. 24a) The Court nonetheless reversed the District Court on the theory that BAR, the nominal plaintiff, was a railroad, and "the public's interest in the financial health of BAR provides a separate interest, quite apart from Amoskeag's, which is served by the corporate cause of action." (App. p. 19a) This "separate interest" of the public, the Court held, was the basis for allowing Amoskeag, through the instrument of the corporate plaintiffs, to bring a suit which would otherwise be barred. The Court stated its view as follows:

> "We see BAR and its management as seeking a corporate recovery in which the public has a real, if inchoate interest. Amoskeag's windfall is irrelevant to that interest, and should not be the factor which determines whether or not BAR may sue." (App. p. 24a)

Although the Court of Appeals held that the presumed public benefit was the sole basis for permitting the suit to be maintained, it admitted that the public would probably

not share, in any recovery by BAR. Specifically, the Court of Appeals conceded that there was a great danger that any recovery by BAR would be syphoned off into the pockets of present stockholders, thus defeating "the very logic by which [BAR, BIC and Amoskeag] are allowed to sue here." (App. p. 25a)

With respect to that possibility, the Court could only suggest that the District Court might attempt to enter some type of order preventing a distribution. It conceded, however, that there was serious question whether the District Court even had the power to enter such an order or whether any "court could properly or practicably regulate . . . the use which a carrier might make of any recovered funds . . .." (App. pp. 25a-26a) In effect, the Court admitted that the public benefit upon which it had premised its decision was probably illusory.

Reasons for Granting the Writ

A. The Court of Appeals' decision herein conflicts with the principles enunciated by this Court in *Sierra Club* v. *Morton*, 405 U.S. 251 (1972), in that it permits a litigant that has itself suffered no injury to maintain an action on behalf of the general public.

It is indisputable that Amoskeag, the owner of over 99% of the stock of BAR, is the real plaintiff and party in interest bringing the instant action. It is also indisputable that Amoskeag, having purchased its BAR stock after the acts complained of and having received full value for its purchase price, has suffered no injury. The Court of Appeals explicity held this lack of injury irrelevant, however, because of an assumed "separate interest" of the general public which it believed would be served by successful prosecution of the action and a recovery herein.

The Court of Appeals' disregard of the lack of injury to the real plaintiff and party in interest is in direct conflict with the rules governing standing recently laid down by this Court in *Data Processing Service* v. *Camp*, 397 U.S.

150 (1970) and *Sierra Club* v. *Morton*, 405 U.S. 727 (1972). In *Data Processing*, this Court stated with regard to standing that "the first question is whether plaintiff alleges that the challenged action has caused him injury in fact, economic or otherwise." 397 U.S. at 152. In *Sierra*, the Court applied this principle, affirming a lower court's decision dismissing the action on the ground that although the plaintiff alleged an injury to a cognizable interest, it did not meet the second element of the test: that the party "be himself among the injured." 405 U.S. at 735.

The *Sierra* case is directly applicable to the case at bar. As in *Sierra*, a party that has itself suffered no injury has caused an action to be brought. Also, as in *Sierra*, the lack of injury is sought to be remedied by allegations of injury to the general public, which general public the plaintiff seeks to represent. The Court's rejection of the Sierra Club's contention is determinative of Amoskeag's right here to sue based on an assumed championship of the public's interest.

Indeed, Amoskeag has even less claim to represent the public interest than did the Sierra Club. The Sierra Club could plausibly maintain that even if it had suffered no injury itself, its long standing commitment to the cause of conservation made it a proper representative of the public interest. Amoskeag, however, can make no such claim. As a registered investment company, its responsibility is to its shareholders, and its duty is to earn as much profit as possible from its investment in BAR. In such a posture, its interests are antagonistic to those of the public serviced by BAR, as the Court of Appeals recognized in its statement that Amoskeag might attempt to siphon off any recovery for its own benefit. (App. pp. 25a-26a) It is inconceivable that Amoskeag would be permitted to bring a class action on behalf of the people of Maine; *a fortiori*, it is an unsuitable party to vindicate their rights.

Beyond the issue of adequacy of representation, however, the crucial point is that the Court of Appeals' decision holds that a party concededly having suffered no injury may sue to vindicate a presumed public interest. The decision

thus directly conflicts with this Court's decisions in *Sierra* v. *Morton, supra* and *Data Processing* v. *Camp, supra,* and throws into question the continued validity of those decisions.

B. The Court of Appeals' decision radically enlarges the boundaries of actions under the antitrust and securities statutes and general corporate law by holding that damage actions which previously could be brought only by shareholders, purchasers and sellers, and direct targets of violations, may now be brought by and on behalf of the general public. If permitted to stand, the Court's decision will be precedent for a wave of individual and class actions heretofore barred.

As pointed out in the Statement of the Case, *supra,* the Court of Appeals agreed that Amoskeag's lack of equity would bar the action under the generally applicable principles, but nonetheless reversed the District Court because of its view that "the public's interest in the financial health of BAR provides a *separate interest,* quite apart from Amoskeag's which is served by the corporate cause of action" (App. p. 19a, emphasis added). The Court's holding was that this assumed public interest provided an independent basis for suit which could support the action.

The foregoing holding—that an assumed public interest in the financial health of a railroad provides an independent basis for maintenance of a private damage action—has far-reaching and revolutionary implications. The claims asserted in this action are for corporate waste and mismanagement, and for alleged violations of the antitrust and securities laws. Herefore, only shareholders, purchasers and sellers, or in the case of the antitrust laws, persons who were the direct targets of violations have been held to have an interest sufficient to provide the basis for a damage action asserting such claims. *Birnbaum* v. *Newport Steel Corp.,* 193 F.2d 461 (2nd Cir. 1952), *cert. denied,* 343 U.S. 956 (1952); *Commonwealth Edison Co.* v. *Allis-Chalmers Mfg. Co.,* 315 F.2d 564 (7th Cir. 1963), *cert. denied sub nom.*

Illinois v. *Commonwealth Edison Co.*, 375 U.S. 834 (1963). The Court of Appeals for the First Circuit now has recognized a new category of persons with such an interest—the general public—and held that a damage suit can be maintained on the public's behalf whenever there is an alleged injury to a private corporation whose business affects the public interest.

The reach of such a holding goes far beyond the instant case. In this action, the Court permitted Amoskeag to sue to champion the public's interest. In another case, the rationale that here permits Amoskeag to sue would require recognition of the right of the public to sue in its own behalf. For if the Court is correct that the public's inchoate and indirect interest is a legal interest upon which suit can be brought, that right cannot depend on the fortuity—present in this case—of the sale of a controlling interest to a new owner. If the interest exists, it must be capable of vindication even in the absence of transfers of stock to new owners and a willingness of those new owners to bring suit. A substantial right cannot depend for its vindication on a chance event and the whim of a stranger, particularly a stranger with interests antagonistic to the public.

The Court's holding thus makes three radical changes in present doctrine. First, it permits suits on behalf of parties at most only indirectly injured. Second, it permits suits by or on behalf of the widest possible group—the general public. Third, it permits suits on the basis of a presumed injury so vague and remote that the Court of Appeals itself described it as "inchoate" and the complaint failed to allege it. (App. p. 24a)

The effect of such a holding is clear. A new cause of action—a private damage action for indirect and inchoate injuries by and on behalf of the general public—has been recognized. Henceforth, so long as a corporation is engaged in a business affecting the public interest, any declaration by it of dividends, any transaction giving rise to

a possible claim under the securities laws, any action arguably in violation of antitrust laws—all may be challenged or sued upon by members of the general public. If permitted to stand, the decision cannot fail to be the forerunner of a wave of individual and class actions unprecedented in volume and scope.

No decision of this or any other court has sanctioned such a bold and radical expansion of standing to bring damage suits for violation of the securities and antitrust laws and corporate waste and mismanagement. It is respectfully submitted that if such a radical and far-reaching change is to be made, it should only be done after careful consideration by and decision of this Court.

C. The decision of the Court of Appeals throws into question the continued validity of the contemporaneous share ownership rule adopted by this Court and subsequently applied by all state and federal courts.

Over ninety years ago, in *Hawes* v. *Oakland,* 104 U.S. 450 (1882), this Court enunciated the contemporaneous share ownership rule that has since become the universal rule governing shareholder actions of the type presented in this action. This rule has been carried over into the present Federal Rules of Civil Procedure as Rule 23.1.

The sound equitable principle which led to the application of the contemporaneous share ownership rule in formal derivative suits was held equally applicable to suits nominally brought by a corporation itself in the landmark case of *Home Fire Ins. Co.* v. *Barber,* 67 Neb. 644, 93 N.W. 1024 (1903). In that case, Dean (then Commissioner) Roscoe Pound held that courts must "look behind the corporation [bringing suit] to the shareholders, who are the real and substantial beneficiaries" of any recovery to the corporation "and ascertain whether these ultimate beneficiaries of the relief it is asked to grant have any standing to demand it." (67 Neb. at 665, 93 N.W. at 1032). Accordingly, where a corporation is controlled by shareholders who were not shareholders at the time of any of the alleged

wrongs, the contemporaneous share ownership rule which barred the shareholders from bringing suit barred the corporation from suing as well.

Every court which has since been confronted with a case similar to the case at bar has dismissed the corporation's complaint on the grounds that the contemporaneous share ownership rule which barred the shareholder barred the corporation. In each case, the courts recognized the obvious fact that to permit recovery by the corporation would merely result in windfall profits to shareholders that had suffered no injury. *Amen* v. *Black,* 234 F. 2d 12 (10th Cir. 1956); *Park Terrace, Inc.* v. *Burge,* 249 N.C. 308, 106 S.E. 2d 478 (1959); *Mathews* v. *Fort Valley Cotton Mills,* 179 Ga. 580, 176 S.E. 505 (1934); *State Trust & Savings Bank* v. *Hermosa Land & Cattle Co.,* 30 N.M. 566, 240 P. 469 (1925); *Pueblo Foundry & Machine Co.* v. *Lannon,* 68 Colo. 131, 187 P. 1031 (1920); *Matthews* v. *Headley Chocolate Co.,* 130 Md. 523, 100 A. 645 (1917); *First State Bank* v. *Morton,* 146 Ky. 287, 142 S.W. 694 (1912).

The decision of the District Court in the instant case thus followed a long line of established precedents. The Court of Appeals' decision, reversing the District Court, brushed aside these distinguished precedents, and enunciating a novel and heretofore unknown exception, viz.: that the rule is inapplicable whenever the nominal plaintiff is a corporation whose business affects the public interest. (App. pp. 18a-19a)

Not only has the exception created by the Court of Appeals never before been recognized; it has been implicitly rejected. In *Home Fire Ins. Co.* v. *Barber, supra,* the first case to give the rule extended consideration, Dean Pound applied the rule in a case where the nominal plaintiff was an insurance company. Similarly, in *First State Bank* v. *Morton, supra,* the rule was applied in an action where the nominal plaintiff was a bank. The fact that the nominal plaintiff is a corporation whose business affects the public welfare, or in whose economic health the public has an interest, has never been considered a valid basis for not applying the rule.

It is unnecessary to go beyond the instant case to understand why this is so. It is undisputed that any corporate recovery in this action will principally benefit Amoskeag, an uninjured shareholder. Yet that is precisely the result the contemporaneous share ownership rule was designed to prevent. The Court of Appeals' exception is inconsistent with the *raison d'etre* of the rule.

The refusal of the First Circuit Court of Appeals to follow a well-settled rule and equitable principle which has stood for nearly 100 years is thus clearly erroneous as a matter of law. Moreover, it is an error with potentially grave and far-reaching consequences. The contemporaneous share ownership rule and underlying principle are embodied in Rule 23.1 and state statutes and decisions throughout the nation. The Court's decision throws into question the scope and continued validity of this widely applied and beneficial rule and principle, and opens the way to the abuse of the shareholder action and corporate form which the rule has heretofore thwarted.

Conclusion

For the foregoing reasons, a writ of certiorari should issue to review the order and opinion of the Court of Appeals for the First Circuit.

Respectfully submitted,

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APPENDIX

December 29, 1972, District Court Opinion

BANGOR AND AROOSTOOK RAILROAD COMPANY and
BANGOR INVESTMENT COMPANY,

Plaintiffs,

v.

BANGOR PUNTA OPERATIONS, INC. and
BANGOR PUNTA CORPORATION,

Defendants.

Civ. No. 1933.

UNITED STATES DISTRICT COURT
D. MAINE, N. D.
DECEMBER 29, 1972.

OPINION AND ORDER OF THE COURT

GIGNOUX, *District Judge.*

This action arises under the Securities Exchange Act of 1934, the Clayton Antitrust Act, the Maine Public Utilities Act, and the common law of Maine. Plaintiff Bangor and Aroostook Railroad Company (BAR) is a Maine corporation which operates a railroad in the northern part of the State of Maine. Plaintiff Bangor Investment Company (BIC), a Maine corporation, is a wholly-owned subsidiary of BAR. Defendant Bangor Punta Corporation (Bangor Punta), a Delaware corporation, is a diversified holding company with operating units in various industries. Defendant Bangor Punta Operations, Inc. (BPO), a New York corporation, is a wholly-owned subsidiary of Bangor Punta. On October 13, 1964, Bangor Punta, through its wholly-owned subsidiary BPO, became the owner of approximately 98.3% of the stock of BAR when BPO acquired all the assets of Bangor and Aroostook Corporation (BAC), a Maine

holding company which BAR had caused to be formed in 1960. From October 13, 1964 until October 2, 1969, Bangor Punta owned through BPO approximately 98.3% of all the outstanding stock of BAR. On October 2, 1969, BPO sold all its stock interest in BAR to Amoskeag Company (Amoskeag), a Delaware investment company controlled by Frederic C. Dumaine, Jr., for a consideration of approximately $5,000,000. Subsequently, Amoskeag has purchased additional BAR shares, and now owns over 99% of all the outstanding capital stock of BAR.

The complaint contains thirteen counts and seeks damages totaling appproximately $7,000,000 for misappropriation and waste of corporate assets alleged to have been caused to BAR by four intercompany transactions, which allegedly took place between BAC or Bangor Punta and BAR during the period between 1960 and 1967, while BAC and then Bangor Punta were in control of BAR. Counts I and II are brought, respectively, under the common law of Maine (Count I) and Section 104 of the Maine Public Utilities Act (35 M.R.S.A. § 104) (Count II). They charge that BAC, and later BPO, improperly charged BAR for nominal legal, accounting, printing and other services furnished BAR by BAC and BPO. Counts III, IV, V and VI are brought, respectively, under the common law of Maine (Count III); Section 10 of the Clayton Antitrust Act (15 U.S.C. § 20) (Count IV); Section 104 of the Maine Public Utilities Act (Count V); and Section 10(b) of the Securities Exchange Act (15 U.S.C. § 78j(b)) and Rule 10b-5 (17 C.F.R. § 240.10b-5) promulgated thereunder by the Securities and Exchange Commission (Count VI). They are based upon the charge that BAC improperly acquired St. Croix Paper Company stock owned by BAR through its wholly-owned subsidiary BIC. Counts VII, VIII, IX and X are brought, respectively, under the common law of Maine (Counts VII and IX); and Section 10(b) of the Securities

Exchange Act and Rule 10b-5 thereunder (Counts VIII and X). They charge that BAC and BPO improperly caused BAR to declare special dividends to its stockholders, including BAC and BPO, and improperly caused BIC to borrow so as to satisfy certain balance sheet ratios required by an earlier loan agreement in order to pay a regular dividend. Counts XI, XII and XIII are brought, respectively, under the common law of Maine (Count XI); Section 10 of the Clayton Antitrust Act (Count XII); and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder (Count XIII). They allege that BAC improperly caused BAR to excuse payment by BAC and BPO of the interest due on a loan made by BAR to BAC. In substance, the complaint alleges that Bangor Punta and its predecessor in interest, BAC, while they were in control of BAR through ownership of 98.3% of its stock, "calculatedly" drained the resources of BAR in violation of law for their own benefit" during the period between 1960 and 1967, prior to the time Amoskeag purchased Bangor Punta's interest in BAR.

Presently before the Court is defendants' motion for summary judgment dismissing the entire complaint, or in the alternative dismissing the two counts brought under the Maine Public Utilities Act (Counts II and V). Defendants seek dismissal of the entire complaint on the ground that Amoskeag, which would be the sole beneficiary of any recovery by the corporate plaintiffs, was not a stockholder of BAR at the time of the alleged improper transactions and itself has sustained no injury as a result thereof. The Court agrees. Since the Court therefore concludes that the entire complaint must be dismissed, it does not reach defendants' alternative motion for dismissal of Counts II and V.

It is true that, as plaintiffs assert, the present action is an action brought by the corporate plaintiffs in their own

right, and does not purport to be a derivative action on behalf of either Amoskeag or the 1% minority stockholders in BAR. But, looking at the substance of the action, it is evident that the real party in interest is Amoskeag, the present owner of over 99% of the outstanding BAR shares. And having purchased the stock of BAR from Bangor Punta in 1969, long after the events complained of occurred, Amoskeag is clearly attempting, by having the corporations which it controls bring the action in their names, to recover the full $5,000,000 consideration paid to Bangor Punta for the BAR shares, plus $2,000,000 more, while still keeping the BAR shares. Amoskeag does not claim that it was deceived or defrauded by Bangor Punta when it purchased its BAR stock, or that it did not get full value for its purchase price. Nor do plaintiffs claim to bring this action on behalf of any creditors or in the public interest. It would accordingly be contrary to settled equitable principles to permit Amoskeag, by thus using the corporate fiction, to acquire a windfall for any past misbehavior on the part of Bangor Punta during the period when Amoskeag had no interest in BAR and sustained no injury, direct or indirect, as a result of Bangor Punta's alleged improper acts.

Plaintiffs admit that the alleged wrongs took place before Amoskeag purchased its BAR stock from Bangor Punta. Under these circumstances, there can be little doubt that Amoskeag would be barred from maintaining a derivative suit on behalf of BAR for the wrongs alleged to have occurred before Amoskeag purchased its BAR shares. As to the claims asserted under the Securities Exchange Act and the Clayton Antitrust Act, Fed.R.Civ.P.23.1 would apply and in terms requires contemporaneous ownership for maintenance of a stockholder derivative action. *Surowitz* v. *Hilton Hotels Corp.*, 342 F. 2d 596, 604 (7th Cir.

1965); *Gottesman* v. *General Motors Corp.*, 28 F.R.D. 325 (S.D.N.Y.1961). To the extent that plaintiffs' claims arise under state law, jurisdiction being based upon diversity of citizenship, there is doubt as to whether the federal rule or state law applies. *See* 3B Moore's Federal Practice (2d ed. 1969) ¶ 23.1.15[2]. The majority of states, however, also have adopted the contemporaneous ownership rule, either by judicial decision or by statute. *Id.* at note 6. And even in those cases where the rule has not been applied, it has been held that a subsequent shareholder cannot sue where, as in the present case, he acquired his stock from the alleged wrongdoer, who himself would have been barred by his participation and acquiescence.[1] *See, e. g., Bloodworth* v. *Bloodworth,* 225 Ga. 379, 387, 169 S.E.2d 150, 156-157 (1969); *Babcock* v. *Farwell,* 245 Ill. 14, 40-41, 91 N.E. 683, 692-693 (1910); *Home Fire Insurance Co.* v. *Barber,* 67 Neb. 644, 661-662, 93 N.W. 1024, 1030-1031 (1903); *Bookman* v. *R. J. Reynolds Tobacco Co.,* 138 N.J.Eq. 312, 372, 48 A.2d 646, 680 (Ch.1946). Plaintiffs instituted the present suit two days prior to the effective date of the new Maine Business Corporation Act, which adopts the contemporaneous ownership rule, 13-A M.R.S.A. § 627(1)(A) (1972). It is an open question in Maine whether the contemporaneous ownership rule applied at the time the present suit was brought. *See* Field, McKusick & Wroth, Maine

1. Plaintiffs allege no facts which would support the allegation in their complaint that "[t]he injury to BAR is a continuing one surviving the aforesaid sale [from BPO] to Amoskeag." There is thus no basis for any suggestion that they may rely upon the "continuing wrong" exception to the contemporaneous ownership rule, which permits a subsequent stockholder to maintain a derivative suit if the alleged wrongful acts and their effects continue and are injurious to to him. Moreover, there is serious question as to whether such an exception should be recognized at all. *Compare* Duncan v. National Tea Co., 14 Ill.App.2d 280, 144 N.E.2d 771, 775 (1957) *with* Weinhaus v. Gale, 237 F.2d 197, 199-200 (7th Cir. 1956); Bowman v. Alaska Airlines, 14 Alaska 62, 14 F.R.D. 70, 72 (1952).

Civil Practice (2d ed. 1970) § 23.2 at 393.[2] But there is no indication in the Maine cases that the Maine court would not have followed the prevailing rule. In such situations, where the law of the particular state is not shown to be in conflict with the federal rule, federal courts will apply Rule 23.1. *Gallup* v. *Caldwell,* 120 F.2d 90, 94-95 (3rd Cir. 1941); *Mullins* v. *DeSoto Securities Co.,* 45 F.Supp. 871, 878 (W.D.La.1942); *see 3B* Moore's Federal Practice, ¶ 23.1.-15[2] at n. 13. Thus, whether the federal rule or Maine law is applicable, Amoskeag could not maintain a derivative action against the defendants.

From the foregoing, it is evident that Amoskeag, by causing the plaintiff corporations to bring this action, is attempting to accomplish indirectly what it could not do directly. Plaintiffs contend that the Court cannot look beyond the corporate form to the substance of the corporate claims and the true beneficiary thereof. But the four inter-company transactions that are the basis of plaintiffs' claims are typical stockholder claims seeking an accounting for alleged misappropriation and waste of corporate assets by controlling stockholders. Equitable considerations must be applied in such actions. *Amen* v. *Black,* 234 F.2d 12 (10th Cir. 1956); *Matthews* v. *Headley Chocolate Co.,* 130 Md. 523,

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2. Defendants point to Hyams v. Old Dominion Co., 113 Me. 294, 93 A. 747 (1915) as indicating the new Maine Business Corporation Act merely codified pre-existing Maine law. In that case, the defendant objected that the plaintiff could not complain because the wrong, if any, was done before he became a stockholder. The court said: "One answer to this, and a sufficient one, is that the wrong is a continuing one." 113 Me. at 302, 93 A. at 750. *See also* Jeffs v. Utah Power and Light Co., 136 Me. 454, 465 12 A.2d 592 (1940). Although it can be argued that by applying the continuing wrong exception to the contemporaneous ownership rule, *see* note 1, *supra,* the Maine court impliedly acknowledged that Maine law required contemporaneous ownership in shareholder actions, the court's cryptic statement is indeed "too enigmatic to be very helpful." Field, McKusick and Wroth, Maine Civil Practice, *supra.*

100 A. 645 (1917); *Home Fire Insurance Co.* v. *Barber, supra.* Nor does characterizing the actions as claims arising under federal statutes save them from the scrutiny of equity. *Columbia Nitrogen Corp.* v. *Royster Co.* 451 F.2d 3, 15-16 (4th Cir. 1971) (antitrust laws); *Royal Air Properties, Inc.* v. *Smith,* 312 F.2d 210, 213-214 (9th Cir. 1962) (securities laws). *See also Edwin L. Wiegand Co.* v. *Harold E. Trent Co.,* 122 F.2d 920, 925 (3rd Cir. 1941) (copyright laws). The equitable principle that the corporate form "will not be allowed to be pushed to the extent of furthering injustice rather than justice" is well established, and has been applied to cases where the plaintiff attempted to use the corporate form to achieve results which he could not accomplish in his own right. *Western Battery & Supply Co.* v. *Hazelett Storage Battery Co.,* 61 F.2d 220, 230 (8th Cir. 1932), cert. denied, 288 U.S. 608, 53 S.Ct. 399, 77 L. Ed. 982 (1933); *Shamrock Oil and Gas Co.* v. *Ethridge,* 159 F.Supp. 693 (D. Colo. 1958). Since Amoskeag, which did not itself incur any damage as a result of defendants' alleged wrongful acts, and not the corporate plaintiffs, is the real beneficiary of any recovery which might be had in the name of the corporate plaintiffs, the corporate claims must fail for lack of equity on the part of those who would ultimately benefit from any corporate recovery.

The applicable principle was stated long ago by Dean Roscoe Pound, then a Commissioner of the Supreme Court of Nebraska, in the leading case of *Home Fire Insurance Co.* v. *Barber, supra:*

> Where a corporation is not asserting or endeavoring to protect a title to property, it can only maintain a suit in equity as the representative of its stockholders. If they have no standing in equity to entitle them to the relief sought for their benefit, they cannot obtain such relief through the corporation or in its own name. (citations omitted). It would be a reproach to courts

> of equity if this were not so. If a court of equity could not look behind the corporation to the shareholders, who are the real and substantial beneficiaries, and ascertain whether these ultimate beneficiaries of the relief it is asked to grant have any standing to demand it, the maxim that equity looks to the substance, and not the form, would be very much limited in its application. 67 Neb. at 664-665, 93 N.W. at 1031-1032.

In *Home Fire,* the court sustained a corporate claim, which it considered to be brought at law, to recover company monies wrongfully withdrawn by Barber and converted to his own use. But the court denied recovery by the corporation upon claims, which it considered to be brought in equity, for corporate mismanagement and waste allegedly committed by Barber, where the existing stockholders, who would be the real beneficiaries of a recovery, had acquired their stock subsequent to the acts complained of, and were hence found to have no standing in equity.

The case of *Amen* v. *Black, supra,* presented facts similar to the instant case. In *Amen,* a corporation, through its receivers, asserted claims for recovery of the profits allegedly realized by Black, its former president and chairman of the Board, from the improper use of company funds and from the sale of corporate stock which Black had wrongfully obtained from the corporation and later sold to N.C.R.A. The court denied relief to the corporation, holding:

> Looking at the substance of the corporate claims and the beneficiaries thereof, it becomes readily apparent that the principal beneficiary of any recovery on behalf of the corporation would be the N.C.R.A. who became the principal stockholder upon the purchase of a majority of the stock in 1947. And having

purchased the stock of the corporation from Black in an arms length transaction, and having received the full value of its purchase, any recovery as stockholder beneficiary of the dissolved corporation would be tantamount to recoupment of the legitimate purchase price of the stock. Obviously there are no equities in such a result, and we therefore hold that the corporate claims must fail for lack of standing to maintain the suit and for want of equity on the part of the beneficiaries in any corporate recovery. 234 F.2d at 23.

Similarly, in *Matthews* v. *Headley Chocolate Co., supra* Headley Chocolate Company commenced an action against Matthews and six other former directors and controlling shareholders to recover damages for the alleged wrongful misappropriation of corporate assets. Subsequent to the alleged wrongs, Matthews had sold a controlling interest in the corporation to one Rodda and his associates. After concluding that Rodda would be barred from maintaining a derivative action, the court stated:

The question then is whether this bill can be sustained in the name of the corporation, and, if so, how the defendants can be protected from claims we have spoken of as not entitled to relief. Inasmuch as by the change of the majority of stock those who were minority stockholders at the time of the transactions complained of are now able to have the suit brought in the name of the company, we are of the opinion that it can be maintained, in that name, instead of in the names of the minority stockholders but for their benefit. But while that is so, if there be any recovery by reason of the claims spoken of, it can only be to the extent of the proportions of the sum recovered due such minority stockholders, if any, as are not barred by

laches, limitations, acquiescence, or other way sufficient to bar them in equity, and anything recovered should be directed to be paid to them by the corporation. Any defense that could have been made against the minority stockholders if they had sued in their own names should be allowed, notwithstanding the fact that the suit is in the name of the corporation. It seems to us that that course is the only one which in equity and justice can be adopted in this case. The purchasers from Matthews have lost nothing, so far as the bill discloses, and if he deceived them in the sale, they have their remedy against him individually, but they should not be permitted to use the corporate name to veil defects in the title to the stock transferred to them by the former stockholder who received about two-thirds of the amounts claimed to have been improperly paid. 130 Md. at 536-537, 100A. at 651.

Thus, the court in *Headley Chocolate,* while holding that the corporation had standing to sue, held it could recover only for those minority stockholders who held their shares at the time of the alleged wrongs and who were not barred by any equitable defenses In the present case, plaintiffs have expressly disclaimed that they are seeking a proportionate recovery on behalf of the 1% minority stockholders in BAR.

The principle that a suit cannot be brought by a corporation where the ultimate beneficiaries of a corporate recovery would be barred was also applied in *Capitol Wine and Spirit Corp.* v. *Pokrass,* 277 App. Div. 184, 98 N.Y.S.2d 291 (1st Dep't. 1950), aff'd, 302 N.Y. 734, 98 N.E.2d 704 (1951).

Research has disclosed no case the holding of which is contrary to that of the foregoing authorities. In *Central*

Railway Signal Co. v. *Longden,* 194 F.2d 310 (7th Cir. 1952), cited by plaintiffs, the court found that there had been no change of ownership of the plaintiff corporation subsequent to the time of the acts complained of. *Id.* at 321. The court's comments on the present question were dictum unnecessary to the decision of the case, and in any event the court seems to be saying no more than that Fed. R.Civ.P. 23 (b) (the predecessor of Rule 23.1) does not apply to a suit by a corporation. *Idem.* Furthermore, it does not appear that Longden, the alleged wrongdoer, was a controlling stockholder, or that the owner of 99% of plaintiffs' stock at the time of suit had acquired its shares from stockholders who had participated in Longden's wrongdoing.

Plaintiffs' final argument is that defendants are in no position to assert equity because if recovery is here denied defendants will be able to keep the fruits of their allegedly wrongful acts. The same argument was made by the plaintiff and rejected by the court in *Home Fire Insurance Co.* v. *Barber, supra.* In the words of Dean Pound:

> But it is said the defendant Barber, by reason of his delinquencies, is in no position to ask that the court look behind the corporation to the real and substantial parties in interest. . . . We do not think such a proposition can be maintained. It is not the function of courts of equity to administer punishment. When one person has wronged another in a matter within its jurisdiction, equity will spare no effort to redress the person injured, and will not suffer the wrongdoer to escape restitution to such person through any device or technicality. But this is because of its desire to right wrongs, not because of a desire to punish all wrongdoers. If a wrongdoer deserves to be punished, it does not follow that others are to be enriched at his expense by a court

of equity. A plaintiff must recover on the strength of his own case, not on the weakness of the defendant's case. It is his right, not the defendant's wrongdoing, that is the basis of recovery. When it is disclosed that he has no standing in equity, the degree of wrongdoing of the defendant will not avail him. 67 Neb. at 673, 93 N.W. at 1035.

For the reasons stated, defendants' motion for summary judgment dismissing the entire complaint is granted.

It is so ordered.

August 3, 1973, First Circuit Opinion

UNITED STATES COURT OF APPEALS

FOR THE FIRST CIRCUIT

No. 73-1059

BANGOR AND AROOSTOOK RAILROAD COMPANY, ET AL.,

Plaintiffs, Appellants,

v.

BANGOR PUNTA OPERATIONS, INC., ET AL.,

Defendants, Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MAINE

Before COFFIN, *Chief Judge,*
McENTEE and CAMPBELL, *Circuit Judges.*

Edward T. Robinson and *Alan L. Lefkowitz,* with whom *Ely, Bartlett, Brown & Proctor, Roger A. Putnam, Howard H. Dana, Jr.,* and *Verrill, Dana, Philbrick, Putnam & Williamson* were on brief, for appellants.

James V. Ryan, with whom *C. Kenneth Shank, Jr., Bruce Topman, Webster, Sheffield, Fleischmann, Hitchcock & Brookfield, Sumner T. Bernstein, Herbert H. Sawyer,* and *Bernstein, Shur, Sawyer & Nelson* were on brief, for appellees.

August 3, 1973

CAMPBELL, *Circuit Judge.* A Maine railroad corporation and its wholly-owned subsidiary bring this action

against their former owners, seeking damages under the federal anti-trust and securities laws, and under state law, for the alleged "looting" of the railroad in 1960-67 when the defendants were in control. Over 99% of its stock was purchased from the old owners after the alleged wrongs. The district court granted defendants' motion for summary judgment, holding that the railroad could not maintain what it termed "typical stockholder claims seeking an accounting for alleged misappropriation and waste of corporate assets by controlling stockholders" since the present owner was not a stockholder at the time of the alleged improper transactions and was not injured thereby. 353 F. Supp. 724, 728 (D. Me. 1972).

Plaintiff, Bangor and Aroostock Railroad Company (BAR),[1] operates a railroad in northern Maine. Plaintiff, Bangor Investment Company (BIC), a Maine corporation, is a wholly-owned subsidiary of BAR. Defendant, Bangor Punta corporation (Bangor Punta), a Delaware corporation the stock of which is listed upon the New York Stock Exchange, is a diversified holding company. Defendant, Bangor Punta Operations, Inc. (BPO), a New York Corporation, is a wholly-owned subsidiary of Bangor Punta.

Bangor Punta, in 1964, through its subsidiary BPO, acquired 98.3% of the stock of BAR, by acquiring all the

[1] It is alleged in the complaint that BAR "is a Maine Corporation organized in 1891 for the purpose of constructing, maintaining and operating a railroad for public use, and has its principal place of business in Bangor, Maine. It operates a railroad providing essential services for those persons and businesses located in the northern part of the State of Maine. BAR connects within the State of Maine with other railroads which serve the northeastern part of the United States, and which, in turn, connect with other railroads serving the remainder of the United States. Freight shipments of BAR consist of products grown and manufactured in the State of Maine, including potatoes, pulp and paper products, which are sold and used in other parts of the United States."

assets of Bangor and Aroostock Corporation (BAC), a Maine holding company established by BAR in 1960. Bangor Punta, through BPO, continued to own 98.3% of BAR's outstanding stock until October 2, 1969, at which time, for $5,000,000, it sold its stock interest in BAR to Amoskeag Company (Amoskeag), a Delaware investment corporation controlled by Frederick C. Dumaine, Jr. Amoskeag later bought additional BAR shares, and now owns over 99% of all the outstanding stock of BAR.

The complaint contains thirteen counts. Damages totalling $7,000,000, for BAR only, are sought on grounds of mismanagement, misappropriation and waste of corporate assets caused by four intercompany transactions taking place among BAC, Bangor Punta, BAR and BIC during the years 1960-67, while BAC and then Bangor Punta were in control of BAR and BIC. The defendants are said to have violated § 10 of the Clayton Act, 15 U.S.C. § 20, and § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder. They are also alleged to have violated the Maine common law and Section 104 of the Maine Public Utilities Act, 35 M.R.S.A. § 104.

The wrongful acts allegedly included overcharge by BAC and BPO for services to BAR; causing BAR to excuse BAC and BPO from interest payments due on loans and to pay improper dividends; the improper acquisition of St. Croix Paper Company stock owned by BAR through BIC; and causing BIC to engage in improper borrowings. In essence, defendants are alleged to have "dominated and controlled BAR and exploited it solely for their own purposes, to the injury of BAR and without regard to BAR's future obligations both to its creditors and to the public which it serves. By such domination, control and exploitation, [defendants] calcula-

tedly drained the resources of BAR in violation of law for their own benefit. . . ."

The defendants moved for summary judgment "dismissing the entire complaint, as amended herein, with prejudice, for the reason that the complaint fails to state a cause of action on behalf of the corporate Plaintiffs; or in the alternative . . . dismissing each of Count II and Count V [brought under the Maine Public Utilities Act] of the amended complaint herein, with prejudice, for the reason that each of them fails to state a cause of action."

The district court granted defendants' motion, stating,

> "Defendants seek dismissal of the entire complaint on the ground that Amoskeag, which would be the sole beneficiary of any recovery by the corporate plaintiffs, was not a stockholder of BAR at the time of the alleged improper transactions and itself sustained no injury as a result thereof. The Court agrees. Since the Court therefore concludes that the entire complaint must be dismissed, it does not reach defendants' alternative motion for dismissal of Counts II and V." 353 F. Supp. at 726.

Starting with the proposition that F.R.C.P. 23.1, the so-called contemporaneous ownership rule, would apply to a shareholder's derivative action brought to enforce the claims asserted here, the district court reasoned that Amoskeag, by causing the plaintiff corporations (essentially BAR) to bring this action, was attempting to accomplish indirectly what it could not do directly; namely, to bring "typical stockholder claims" for misappropriation and waste. Since Amoskeag,

> "which did not itself incur any damage as a result of defendants' wrongful acts, and not the corporate plaintiffs, is the real beneficiary of any recovery

which might be had in the name of the corporate plaintiffs, the corporate claims must fail for lack of equity on the part of those who would ultimately benefit from any corporate recovery." 353 F. Supp. at 728.

The district court relied on Commissioner Roscoe Pound's opinion in *Home Fire Ins. Co.* v. *Barber*, 67 Neb. 644, 661-62, 93 N.W. 1024, 1030-31 (1903), and like cases. *See, e.g., Capitol Wine & Spirit Corp.* v. *Pokrass*, 277 App. Div. 184, 98 N.Y.S.2d 291, *aff'd*, 302 N.Y. 734, 98 N.E.2d 704 (1951); *Amen* v. *Black*, 234 F.2d 12, 23 (10th Cir. 1956). *Matthews* v. *Headley Chocolate Co.*, 130 Md. 523, 100 A. 645 (1917). *Home Fire* and its successors hold that a person who was not a stockholder at the time of the alleged mismanagement of a corporation may not later sue derivatively, nor, if he becomes the sole stockholder, may he cause the corporation itself to sue. Central to the conclusion that even the corporation may not sue is the assumption that "the shareholders . . . are the real and substantial beneficiaries of a recovery." *Home Fire Ins. Co.* v. *Barber, supra*, 67 Neb. at 664, 93 N.W. at 1031. Equity, "penetrating all fictions and disguises", treats the corporation as the alter ego of its stockholders: because it would be unjust to enrich them, the corporation may not be enriched. A corollary is that the corporation is barred from suing only if recovery would inure solely to the benefit of the estopped stockholders. If other eligible interests, such as creditors or minority shareholders, would benefit, the corporation may sue; since recovery is for the corporation the estopped stockholders would also benefit, but that is "an injustice which might be necessary to be suffered. . . ." *Capitol Wine & Spirit Corp.* v. *Pokrass, supra*, 98 N.Y.S.2d at 293.

The *Home Fire* rule prevents a purchaser of all or most of the corporate stock, who probably purchased it at a price tied to the value of the assets at the time of sale, from recovering a windfall. Where maintenance of the corporate cause of action serves no other interest, such a result seems reasonable—although we leave open whether the equities reflected in *Home Fire* should be permitted to prevent suits under laws, such as the federal anti-trust and securities acts, that were enacted to protect interests other than, or in addition to, those of the current stockholders. *Cf. Perma Life Mufflers, Inc.* v. *International Parts Corp.*, 392 U.S. 134, 139 (1968).

Our difficulty here, however, is more fundamental. Even accepting *Home Fire*, we doubt its applicability. We reject the premise — critical both to the district court's holding and to the *Home Fire* rationale — that BAR's chief stockholder, Amoskeag, would be the "sole beneficiary" of a recovery for BAR. The premise, applied to a rail carrier, seems to us to be an over-simplification, although, without doubt, BAR's recovery would be highly beneficial to Amoskeag. Because of the nature of their services and of regulatory restrictions affecting them, and, more generally, because of their legal status as "quasi-public corporations", railroads cannot realistically be described as mere alter egos of their chief stockholders. If BAR's management complies with the law, recovery of monies by BAR may be expected not only to benefit its stockholders but to improve the economic position of the carrier, enabling it to enhance its services and helping stave off the financial crisis faced today by so many railroads. The net result will be of likely benefit to the public. Such considerations might be irrelevant in cases involving ordinary, closely held businesses; their survival is not usually deemed to be of public concern and they are typically

viewed as mere projections of their stockholders. But courts — even before passage of extensive regulatory laws — have for years held that the public has an identifiable interest in a railroad corporation and in its ability — including its financial ability — to provide services and, indeed, to survive.

The public's interest, unlike the private interest of stockholder or creditor, is not easily defined or quantified, yet it is real and cannot, we think, be overlooked in determining whether the corporation, suing in its own right, should be estopped by equitable defenses pertaining only to its controlling stockholder. Here we think the public's interest in the financial health of BAR provides a separate interest, quite apart from Amoskeag's, which is served by the corporate cause of action.[2] Thus, regardless of

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[2]Under the view we take of the case, we need not consider the district court's conclusion that the present suit is not being maintained in any meaningful way on behalf of the less than 1% of stock not owned by Amoskeag.

Nor do we analyze the extent to which the contemporaneous stock ownership rule is mandated, in a non-derivative action, by F.R.C.P. 23.1. Whether a stockholder is equitably barred from suit because he did not own the stock at the time of the alleged wrong or because he acquired it from wrongdoers is significant here only if we accept the district court's premise—as we do not—that BAR's controlling stockholder is the sole beneficiary of the instant litigation.

It can be argued, of course, that F.R.C.P. 23.1, dealing with derivative suits, does not establish a federal rule of contemporaneous ownership with respect to non-derivative proceedings. The underlying policies for adoption of the Rule—preventing transfer of a few shares to a non-resident to acquire diversity jurisdiction and to discourage strike suits—relate to abuses associated with minority stockholder proceedings. *See Hawes* v. *Oakland*, 104 U.S. 450 (1882); 3B Moore's Federal Practice, ¶ 23.1.15. The Maine Supreme Judicial Court has recently indicated willingness to relax the contemporaneous ownership requirement where fairness and sound policy warrant. *See Forbes* v. *Wells Beach Casin, Inc., et al.*, Docket No. 930, Law Docket No. 1688, June 28, 1973.

the latter's motivations or potential receipt of undeserved benefits, BAR should be permitted, and indeed has a duty, to recover for itself any assets which were divested from it in violation of state or federal law.

A railroad is a "public" or "quasi-public" corporation. *United States* v. *Trans-Missouri Freight Ass'n*, 166 U.S. 290, 321-22, 332-33 (1897); *Railroad Com'rs* v. *Portland and O.C.R.R.*, 63 Me. 269, 18 Am. Rep. 208 (1872); for a recent state case reafirming the traditional concept, *see Louisville and Nashville Ry.* v. *Sutton*, 436 S.W.2d 487, 490 (Ky. Ct. App. 1969); *see generally* 1 Fletcher Cycl. Corps., § 63 (1963). According to the Maine Supreme Judicial Court,

> "Railroad charters are contracts made by the legislature in behalf of every person interested in anything to be done under them." *Railroad Com'rs* v. *Portland and O.C.R.R., supra*, 63 Me. at 278.

The provision of roads and "other artificial structures" for travel is a duty of government recognized from earliest times. *Id.* at 275. The granting of a franchise to operate a railroad was seen by the Maine court as a farming-out by government of a duty owed to the public.

> "The fare is the consideration for the service performed, whether done by the State directly, or by a corporation under a grant from the State; it is simply a substitute for the tax rendered necessary when the State builds and conducts railroads at the public expense; the corporation, upon the payment of the fare, is under the same obligation to render the required service for the public, that the State would be, if railroads were free, and conducted by State authority. Nor does the ownership of railroads, whether it be

> in the State or a private corporation, affect the nature of their use, since in either case the function to be exercised and the uses to be subserved are public." *Id.* at 275-76.

It can, of course, be argued that all manner of businesses are affected with a public interest. *See Munn* v. *Illinois*, 94 U.S. 113 (1877) (regulation of private grain elevators). However that may be, railroads, involving the use and often the forced taking of interests in land[3] and providing essential transportation, have acquired a unique status in our law; they were said by the Maine court in *Railroad Com'rs* v. *Portland and O.C.R.R., supra,* 275, to be "preeminent" among private instrumentalities affected with a public interest. While the development of other modes of transportation has eroded this "preeminence", the Maine courts have not modified their view of the unique legal status of railroad companies, which are also regulated "public utilities" under Maine law, 35 M.R.S.A. § 15.13 *et seq.*

Federal courts, including the Supreme Court, early took the same view of the public or quasi-public character of railroads. In *United States* v. *Trans-Missouri Freight Ass'n, supra,* 166 U.S. at 332-33, the Supreme Court said,

> ". . . railways are public corporations organized for public purposes, granted valuable franchises and privileges, among which the right to take the private property of the citizen *in invitum* is not the least, . . . many of them are donees of large tracts of public

[3] Beginning in 1850, Congress lavishly subsidized railroad construction by land grants: for example, an estimated 40,000,000 acres was granted to the Northern Pacific, *Great Northern Ry.* v. *United States,* 315 U.S. 262, 276 (1942). Under Maine law, land may be taken for railroad purposes by eminent domain. 35 M.R.S.A. § 651 *et seq.*

> lands and of gifts of money by municipal corporations, and . . . they all primarily owe duties to the public of a higher nature even than that of earning large dividends for their shareholders. The business which the railroads do is of a public nature, closely affecting almost all classes in the community . . . ."

More recently, the public importance of the rail carriers has been recognized in context of the economic crisis threatening their continued existence. Indeed, since the temporary nationalization of the railroads in World War I, the preservation of the railroads has been a national concern. Interpreting the Transportation Act, 1920, Mr. Justice Brandeis said,

> "By that measure, Congress undertook to develop and maintain, for the people of the United States, an adequate railway system. It recognized that preservation of the earning capacity, and conservation of the financial resources, of individual carriers is a matter of national concern; . . ." *Texas & Pac. Ry.* v. *Gulf, etc. Ry.*, 270 U.S. 266, 277 (1926).

In 1933, Congress added Section 77 to Chapter VIII of the Bankruptcy Act, providing for the financial reorganization of ailing railroads. A policy of Section 77 is "that the operation of railroads as sound, economic units should be achieved for the benefit of the public, regardless of the interests of creditors and stockholders." 5 Collier on Bankruptcy, 14th ed., ¶ 77.02. p. 469. In *Reconstruction Finance Corp.* v. *Denver & R.G.W.R.R.*, 328 U.S. 495, 536 (1946), the Court said, "[B]y their entry into a railroad enterprise, [security holders] assumed the risk that in any depression or any reorganization the interests of the public would be considered as well as theirs." *See New Haven Inclusion Cases*, 399 U.S. 392, 492 (1970). *Cf.* Note,

Takings and the Public Interest in Railroad Reorganization, 82 Yale L.J. 1004 (1973). Worry over the public effect of the Northeastern railroads' insolvency appears in the Interstate Commerce Commission's *Northeastern Railroad Order of Investigation* (Ex Parte No. 293, Feb. 7, 1973, 38 Fed. Reg. 6253 (1973)), noting the entry into Section 77 reorganization of seven Class I railroads, and the danger that acute cash crises of several might lead to the eventual cessation and liquidation of the transport facilities of the carriers. The I.C.C. found these matters to "create implications of nationwide importance." Similar concern resulting from the Penn Central financial crises was expressed in Senate Joint Resolution 59 approved Feb. 9, 1973 (P.L. 93-5, 87 Stat. 5, 1973 U.S. Code Cong. & Ad. News 379).

In 1960 the Maine Supreme Judicial Court concluded that local freight lines (BAR is one such) were crucially important to the Maine economy. The court said, in *Maine Cent. R.R.* v. *Public Utilities Comm'n*, 156 Me. 284, 163 A.2d 633, 637 (1960):

> "There can be no question as to the very real need which the whole public of Maine has for an efficient freight service by rail. There are many raw materials and products of great weight and bulk which can only be carried efficiently in and out of Maine in freight cars. This state is somewhat remote from the principal markets and thus dependent on fast and economical transportation of goods. We are engaged in spirited competition with our sister states for new industry which will add to payrolls and taxes and assure the economic health of Maine. Moreover, existing established industry must be encouraged and preserved and agriculture must not be deprived of indispensable freight service. Here we are dealing with

> the *public interest* in its broad sense for every citizen of Maine has a stake in the industrial and economic vitality of his state."

Given today's circumstances of which we are all generally aware, and the legal history above cited, it would be unrealistic to treat a railroad's attempt to secure the reparation of misappropriated assets as of concern only to its controlling stockholder. To do so grants to the defendants an undeserved immunity from suit, to the disadvantage of the public, solely to avoid a windfall to Amoskeag which, whatever its own lack of equity, is neither a wrongdoer nor a participant in any wrong. We see BAR and its management as seeking a corporate recovery in which the public has a real, if inchoate interest. Amoskeag's windfall is irrelevant to that interest, and should not be the factor which determines whether or not BAR may sue.

Moreover, to prevent BAR from suing to recover assets wrongfully divested is to reject the use of private litigation as a deterrent to patently undesirable conduct. The management of a rail carrier — whoever it may be and whatever its private aims — is best situated to learn of wrongs to the railroad and to take effective action to redress them. The looting of a railroad and its possible decline or even failure are so clearly violative of state and federal policies, as expressed both in legislation and in the decisions of courts, as to invite the encouragement of private lawsuits as a supplement to public enforcement. *See J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964); *Perma Life Mufflers, Inc.* v. *International Parts Corp., supra*, 392 U.S. at 139. The private financial incentive for those bringing the action helps assure that it will be brought; federal and state agencies, sometimes hampered by inadequate funding or diverted by other concerns, may not be able to take the necessary action.

Thus we hold that neither the federal nor the state counts are foreclosed by the failure of BAR's principal stockholder to own its stock during the period of the wrongful conduct nor by Amoskeag's purchase of the stock from the alleged wrongdoers.

We are left with a final major question which we do not now attempt to resolve; namely, the extent, if any, to which the district court should try to insure that recovery, if any, does not benefit Amoskeag at the expense of the railroad and the public which it serves. If BAR should recover, Amoskeag's BAR stock will increase in value. An increase in stock value is a windfall which can hardly be avoided; it would not be inconsistent with the public's interest in a healthier railroad. On the other hand, a syphoning off of BAR's recovery into the pockets of present stockholders or others would be different. Hopefully, the very logic by which appellants are allowed to sue here may help to deter at least illegal distributions. In any event, we have no doubt of the power of the district court, in conjunction with any recovery, to enter orders, if appropriate, prohibiting distributions by BAR that would conflict with state or federal law. A more difficult question arises with respect to its ability to enter more sweeping prohibitions to ensure that BAR's recovery is not unreasonably diverted for the private enrichment of its stockholders.

If plaintiffs prevail, the latter is a matter which the parties and the district court may consider further, possibly with the invited assistance of state and federal agencies. Our ruling that the plaintiffs may sue is not conditioned on the devising of court-imposed limitations on the uses of any corporate recovery. Even without limitations, the public interest is better served than were civil immunity to be assured to those who may have

syphoned funds from a rail carrier in violation of State and federal law. Whether a court could properly or practicably regulate (beyond existing state and federal law) the use which a carrier might make of any recovered funds, we are not prepared to decide at this time.

We understand the district court's order for summary judgment to be based solely on its determination that plaintiffs were barred from suing because of Amoskeag's failure to own stock at the time of the alleged wrongs and its purchasing of stock from alleged wrongdoers. Our decision reverses that determination; it leaves all other issues open, including the merits of plaintiffs' claims, which have yet to be tried. The district court not having ruled thereon, we express no opinion on defendants' motion, on different grounds, to dismiss Counts II and V.

Reversed and remanded for proceedings consistent herewith.

Statutes and Regulations Involved

1. Clayton Act § 10, 15 U.S.C. § 20, reads in pertinent part as follows:

> No common carrier engaged in commerce shall have any dealings in securities, supplies, or other articles of commerce, or shall make or have any contracts for construction or maintenance of any kind, to the amount of more than $50,000, in the aggregate, in any one year, with another corporation, firm, partnership, or association when the said common carrier shall have upon its board of directors or as its president, manager, or as its purchasing or selling officer, or agent in the particular transaction, any person who is at the same time a director, manager, or purchasing or selling officer of, or who has any substantial interest in, such other corporation, firm, partnership, or association, unless and except such purchases shall be made from, or such dealings shall be with, the bidder whose bid is the most favorable to such common carrier, to be ascertained by competitive bidding under regulations to be prescribed by rule or otherwise by the Interstate Commerce Commission. No bid shall be received unless the name and address of the bidder or the names and addresses of the officers, directors, and general managers thereof, if the bidder be a corporation, or of the members, if it be a partnership or firm, be given with the bid.

2. Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) reads as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
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> • • •

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

3. SEC Rule 10b-5 (17 C.F.R. § 240.10b-5) reads as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange.

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

4. Federal Rule of Civil Procedure 23.1 reads as follows:

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a share-

holder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.